



The 2013 SIGMA Collateral Survey Results and Analysis

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In the last quarter of 2013, SIGMA Actuarial Consulting Group invited a group of insurance brokers, risk management consultants, and risk management staff of self-funded concerns to participate in a survey regarding collateral. This survey was similar to the ones conducted by SIGMA in 2009 through 2012.

The goal of the survey was to assess, on a national basis, trends in collateral negotiations, exposures, reviews, arbitration, litigation, and other factors that SIGMA actuaries have been seeing with our own clients.

Summary of Results

Highlights of the 12 question survey, which received 67 respondents show:

- The percentage of respondents indicating that most of the parameters of the agreement were negotiated prior to the policy inception has continued to decrease since 2010. The percentage of respondents indicating that some of the parameters of the agreement were negotiated has continued to increase since 2010.
- In 2013 there was approximately a 12% increase in the respondents indicating they used actuarial consultation or analysis in support of collateral issues.
- Most of the respondents indicated that workers compensation was the primary risk related to their responses. Most respondents also indicated that workers compensation was the most difficult risk related to collateral issues.



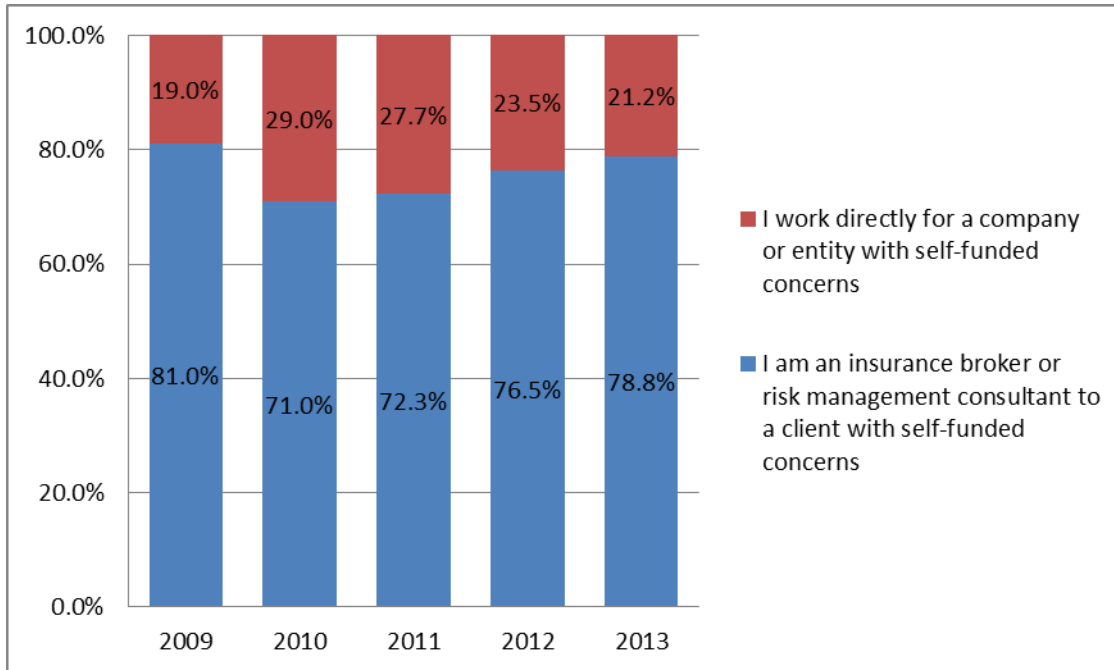


Details of the survey, including commentary for each question, follow. At the end of this report, we present recommendations for improving an entity's collateral picture, and a list for further reading.





Question 1: Which best describes your professional role in collateral issues?

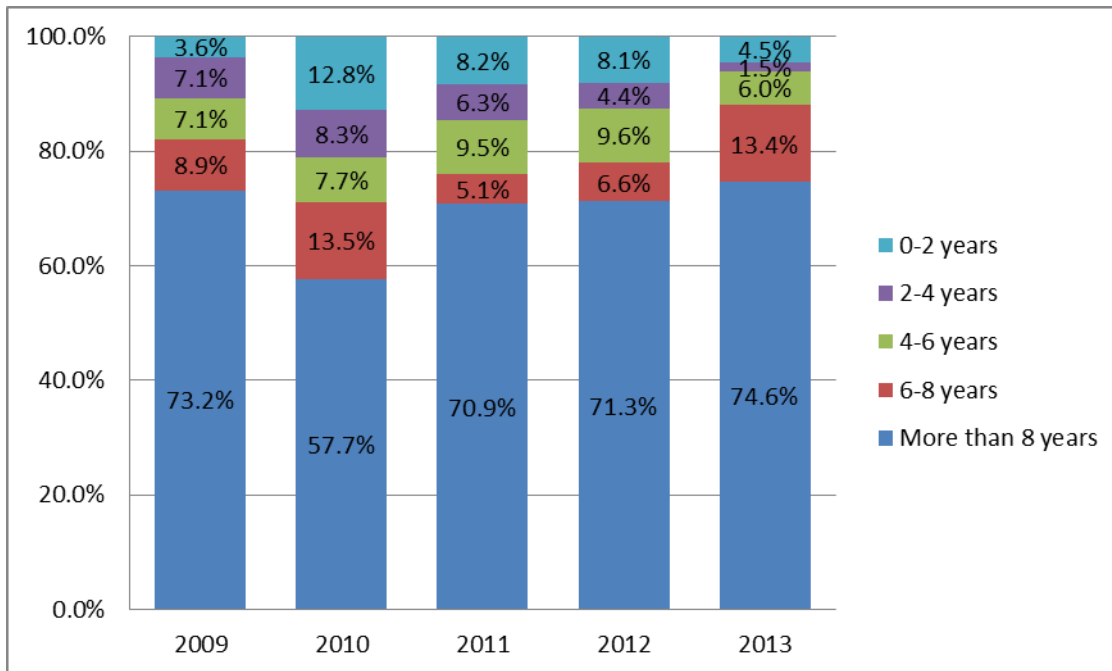


The first survey question addressed the professional role of the respondent. Approximately 78.8% of the respondents represented a client as a broker or risk management consultant and approximately 21.2% worked directly for a company with collateral concerns. Survey instructions guided risk managers and brokers to respond to the survey multiple times if they wished to respond on behalf of multiple clients. Therefore, each survey response should reflect the collateral situation for a single entity. The professional role of the respondent has varied little over the five years of surveys.





Question 2: Which category best represents the number of years you have posted collateral for self-funded liabilities?

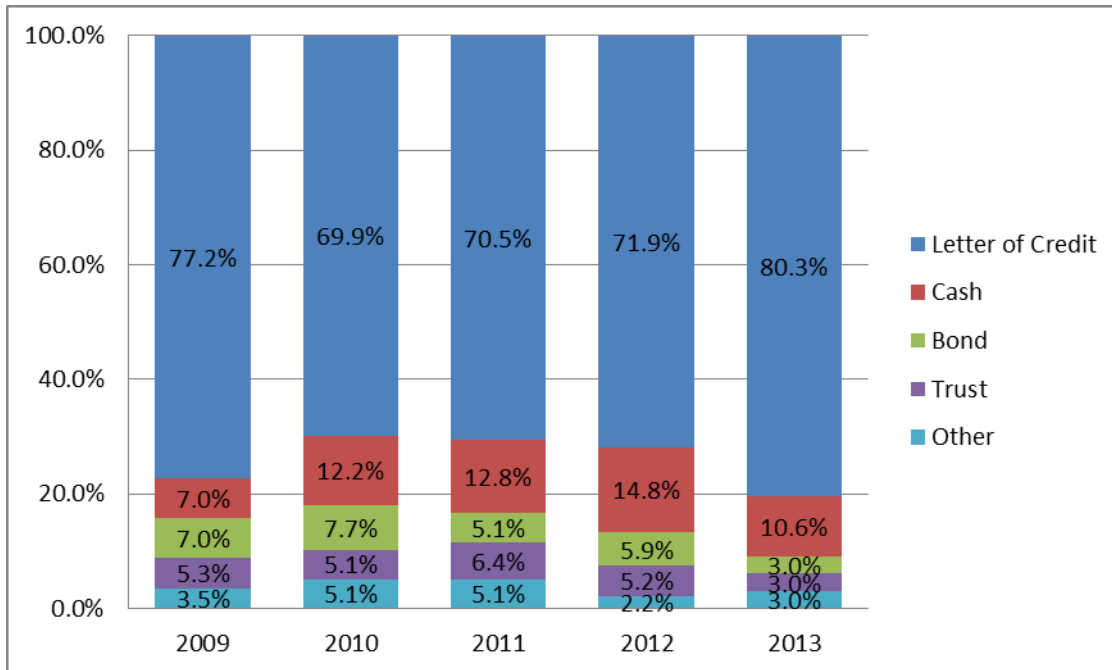


The results from the 2013 survey do not differ significantly from the 2012 results for this question. As we noted in our prior collateral reports, companies that have posted collateral for several years have a greater likelihood of being in a stable position. This means that the “add on” collateral related to exposures for the upcoming year is approximately offset by payments being made on the more mature policy periods. Companies that have only recently started posting collateral can often see significant increases in required collateral as new years are added. This is especially true for workers compensation, general liability and other long tailed coverages. These coverages have a long payout pattern (losses pay out over several years).





Question 3: Which instrument best describes the type of collateral instrument used for your self-funded liabilities?

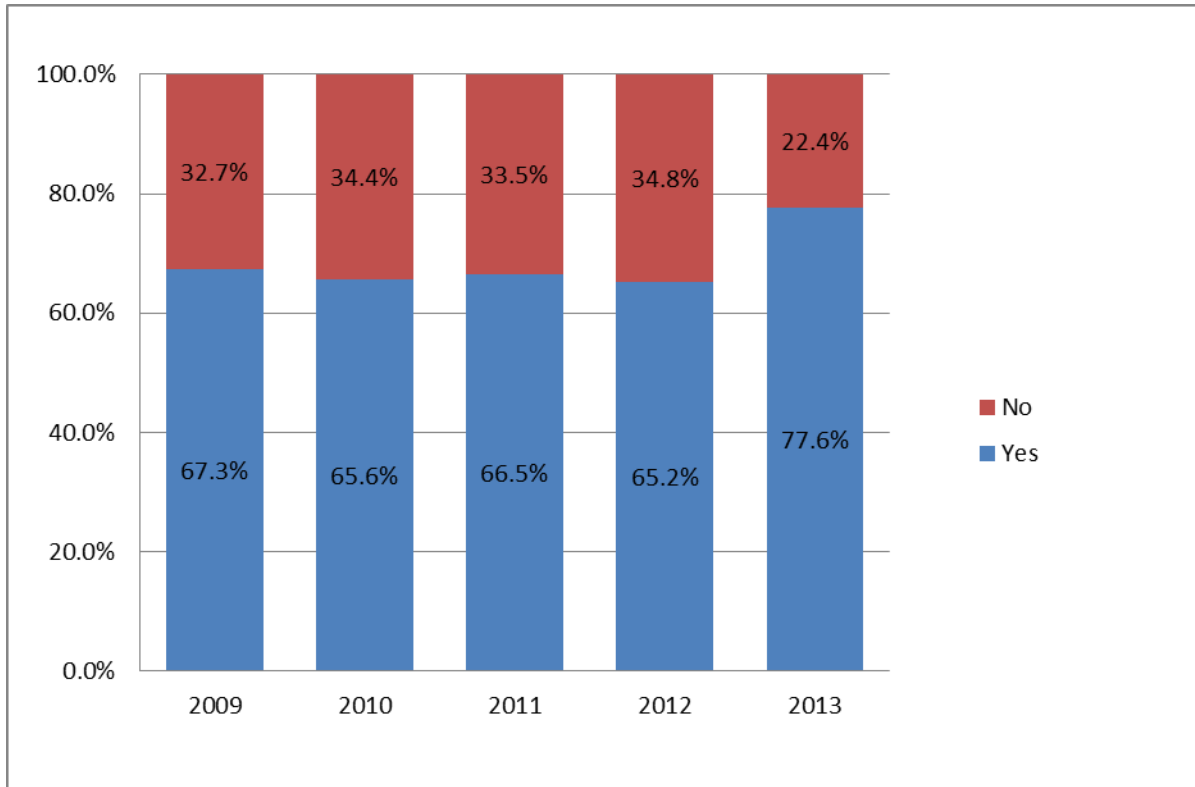


The third question addressed the type of collateral instrument used. The use of cash as a collateral instrument showed a decrease in 2013 and is currently at 10.6%. The use of letters of credit as a collateral instrument showed an increase of approximately 8% from the previous year.





Question 4: Do you have actuarial consultation or analysis in support of collateral issues?



Question 4 addressed the use of actuarial services. The responses were consistent in the first four surveys with approximately 65%-67% using actuarial support. The use of actuarial support showed an increase of approximately 12% in 2013.

It is important to note that the question did not delineate between using an annual actuarial report versus engaging actuarial consultation and analysis specifically related to collateral concerns. Annual actuarial reports often contain a significant amount of information that could be useful in collateral negotiations. However, the evaluation date of an actuarial report may differ from the evaluation date used by a carrier for collateral calculations and reviews.

Normally, actuarial support involves calculating the required reserves for specified collateral years. Required reserves are determined by calculating estimated ultimate



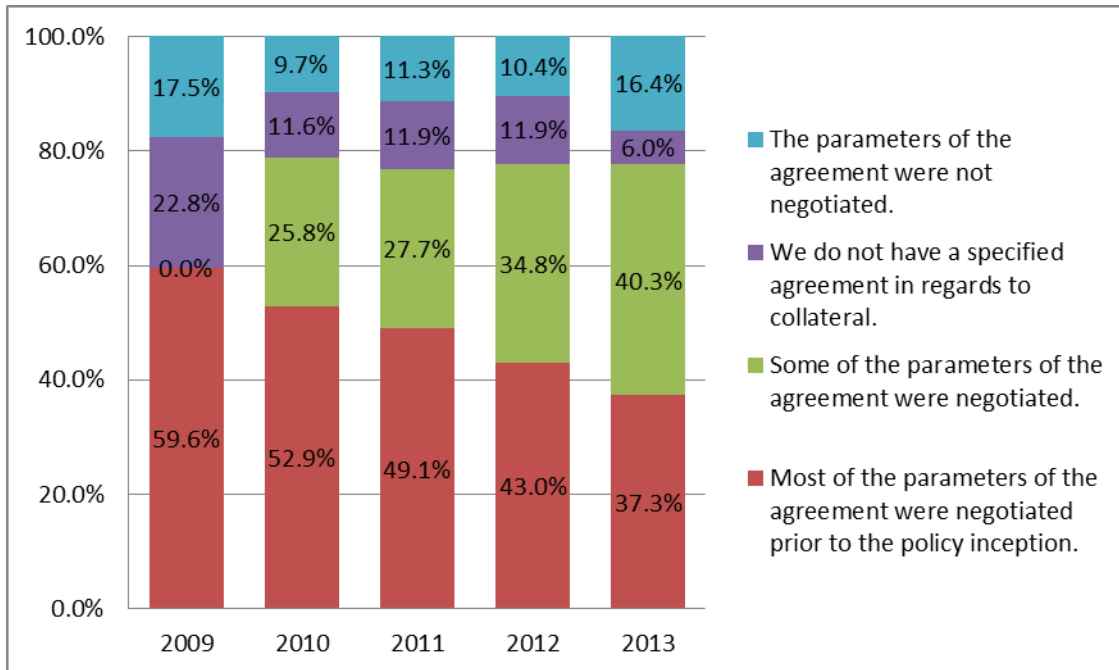


losses and subtracting the paid losses as of the evaluation date. If a carrier provides work papers, the carrier's actuarial analysis can be compared to the collateral analysis to determine key differences. The differences are commonly related to loss development factors or methodology related to risk margins.





Question 5: Which of the following statements best reflects your collateral agreement?



Many times in our consultative practice, SIGMA only becomes involved in collateral negotiations after the collateral has been posted for one or more years. Often these negotiations are hindered due to a lack of a front-end collateral agreement. Question 5 attempts to gauge the percentage of companies that establish an agreement prior to entering a collateral partnership.

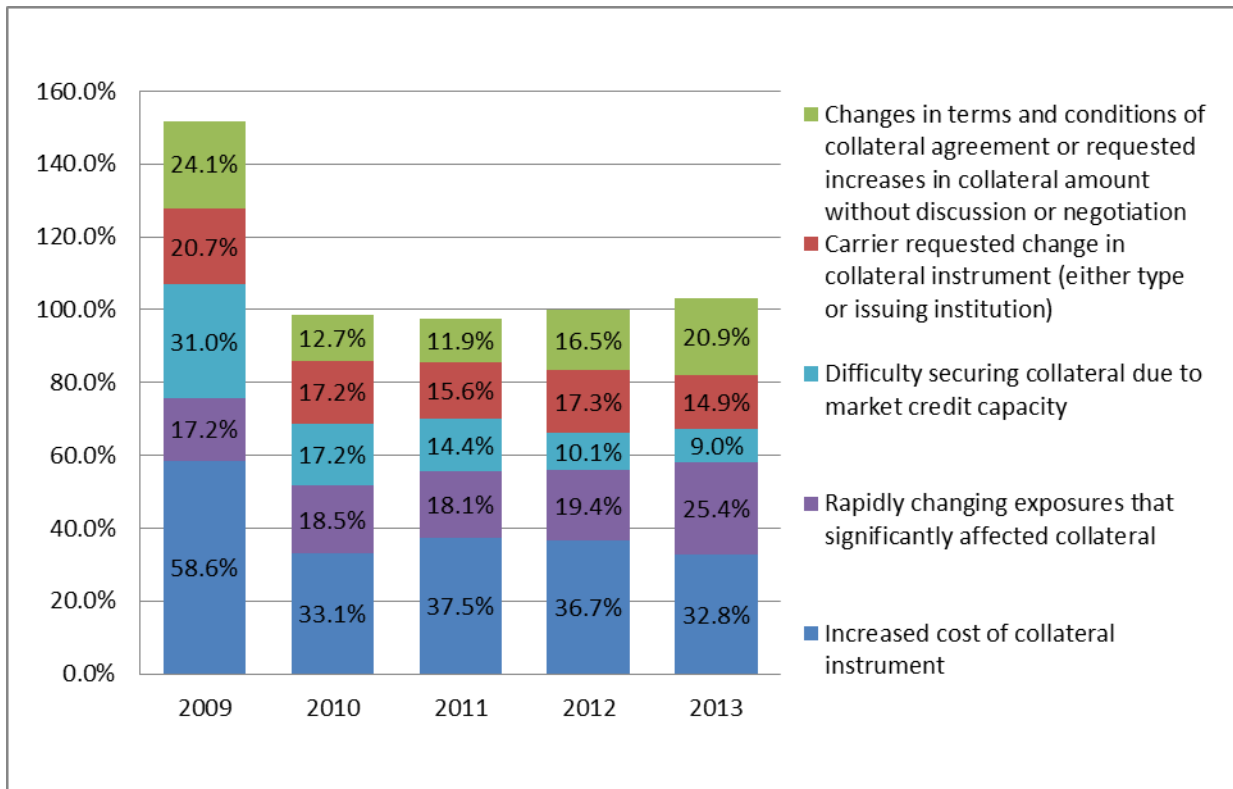
A response option was added to the 2010 survey: “Some of the parameters of the agreement were negotiated”. SIGMA added this option after we read and processed the results of the 2009 survey. Based on the 2009 responses, many companies secured an agreement and had negotiated at least some of the parameters of the agreement.

Since 2010 the number of respondents indicating that most of the parameters were negotiated has declined, while the number indicating that some of the parameters were negotiated has increased.





Question 6: Did you experience any of the following in regards to collateral posted for self-funded workers compensation liabilities?



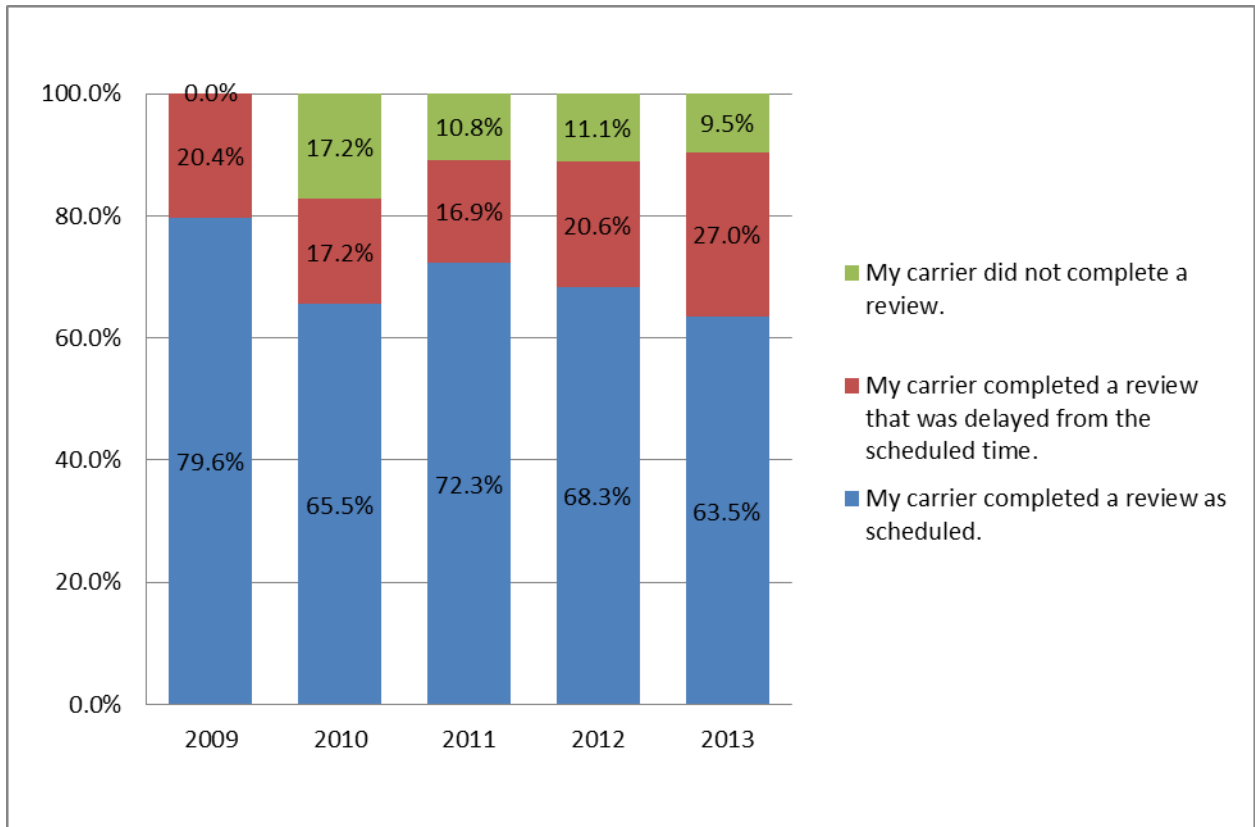
Question 6 focuses on changes that occurred in the company's workers compensation collateral situation during 2009 through 2013. The survey instructed respondents to select all changes that applied. Therefore, the percentages can total to more than 100%.

This particular question shows the biggest movement in responses from 2009 to 2010 and the responses stabilized between 2010 and 2013. In 2013, the most significant increase was related to respondents indicating "rapidly changing exposures that significantly affected collateral".





Question 7: Which of the following best describes how your carrier reviewed the collateral held in the year?

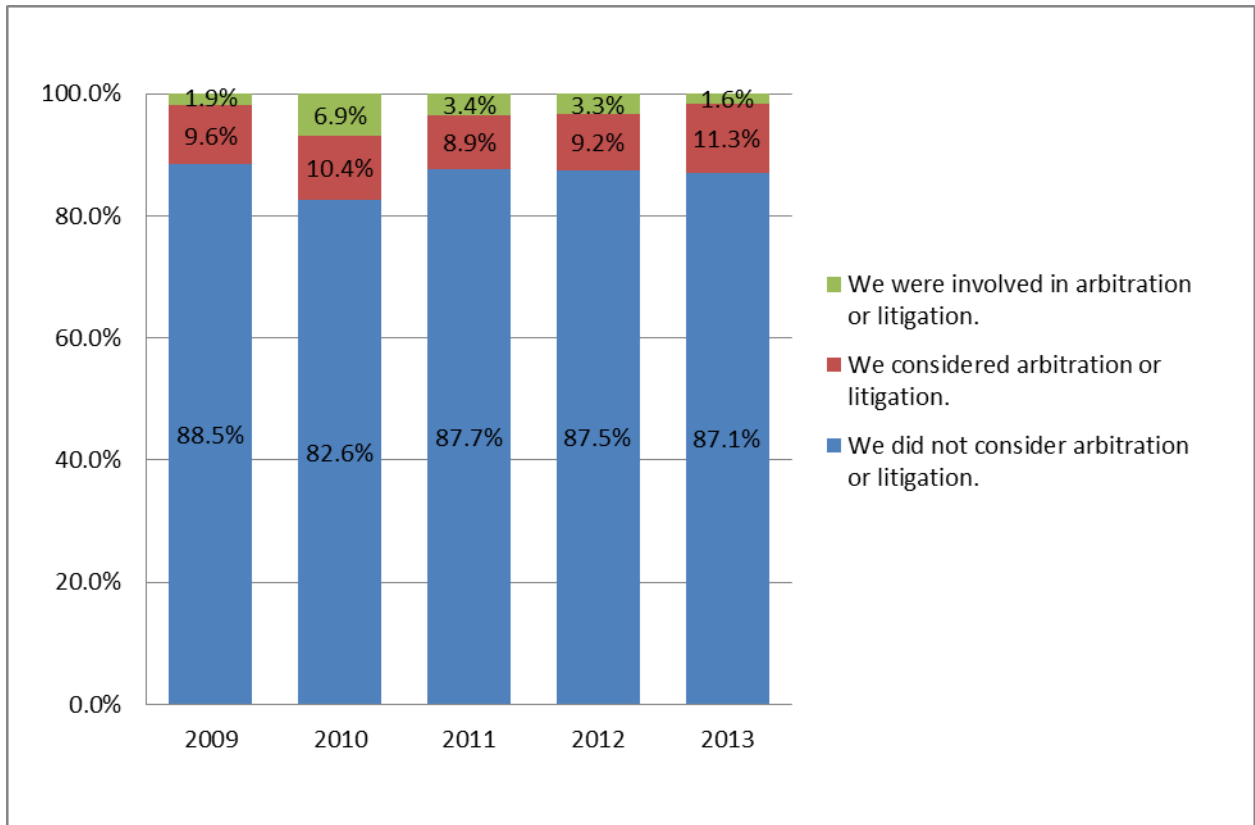


Question 7 focused on carrier collateral reviews. It should be noted that in 2009 the option “My carrier did not complete a review” was not available to the respondents. The response “my carrier completed a review as scheduled” has varied from 63.5% to 79.6% over the five year period.





Question 8: Which of the following best describes your collateral situation?



Over recent years, SIGMA has experienced an increase in requests for actuarial support in litigation or arbitration related to collateral issues. This support can include the completion of an expert report or expert testimony. Question 8 attempts to gauge the percentage of companies considering or involved in litigation. In 2010, there was an increase in the number of companies involved in litigation or arbitration (from 1.9% to 6.9%) and an approximate corresponding decrease in the number of companies that did not consider arbitration or litigation. From 2011 to 2013 the results are similar and a decrease occurred over the 2010 level in the number of companies that considered arbitration or litigation.

Collateral litigation often focuses on two key areas: the interpretation of the agreement language and the actual calculation of the collateral amount. In our experience,



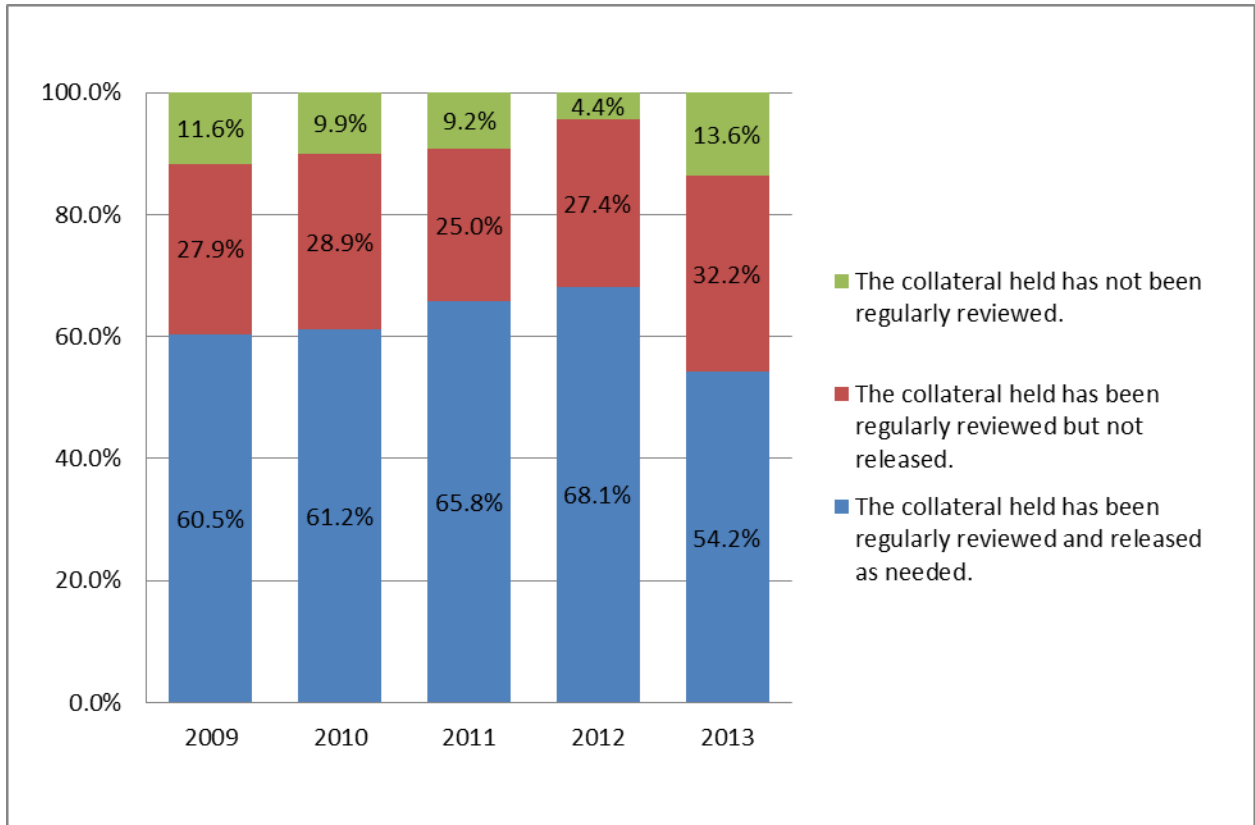


litigation and arbitration are more common in run-off situations, which are addressed in the next two questions.





Question 9: Which of the following best describes the run-off collateral release?

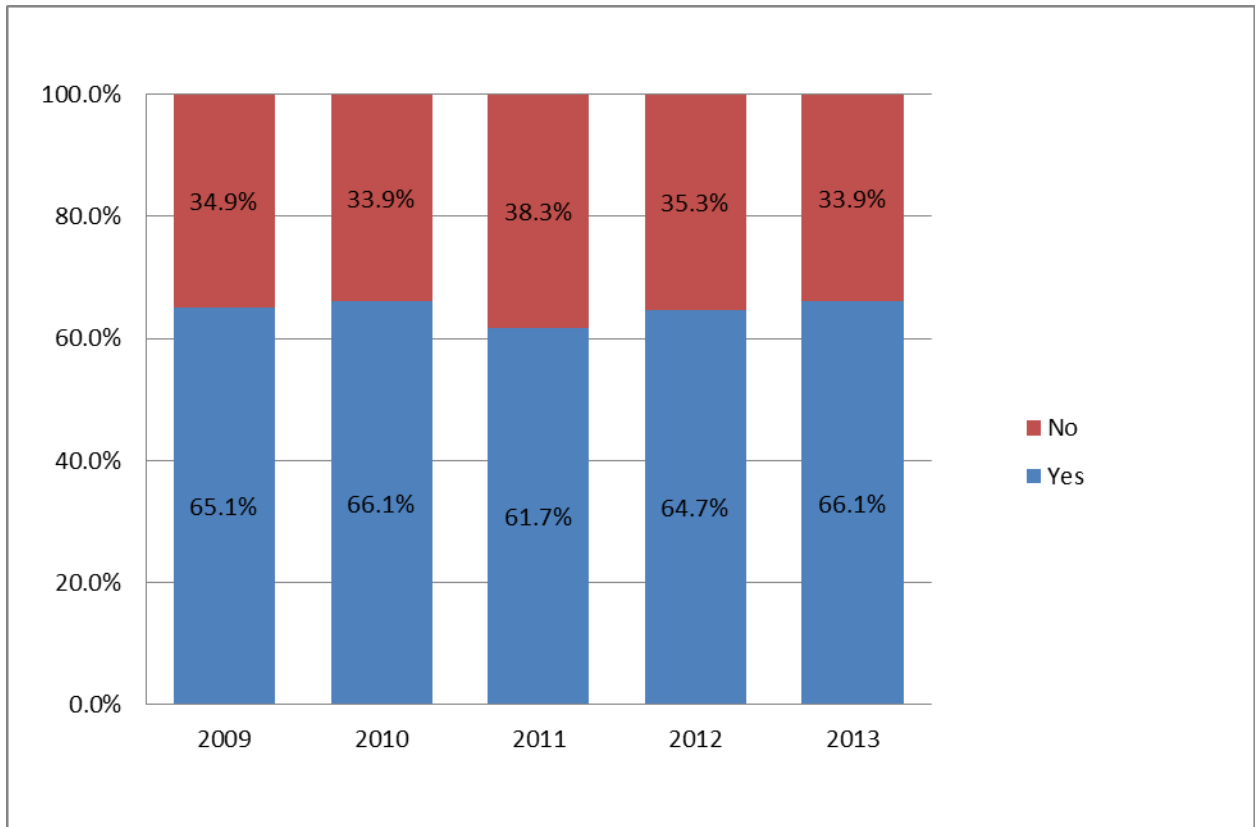


Questions 9 and 10 of the survey focused on collateral issues related to “run-off” situations. This occurs when a company has collateral held by a carrier that is no longer their current carrier. In this situation, there is no “add-on” collateral and the old years are winding down as claim payments are made. Historically, we have found that in these instances a carrier may often be less willing to negotiate the collateral amount. The responses to this question were very consistent between 2009 and 2011. Respondents indicated a decrease in 2013 in the percentage indicating collateral has been regularly reviewed and released as needed and an increase in the percentage indicating collateral has not been regularly reviewed.



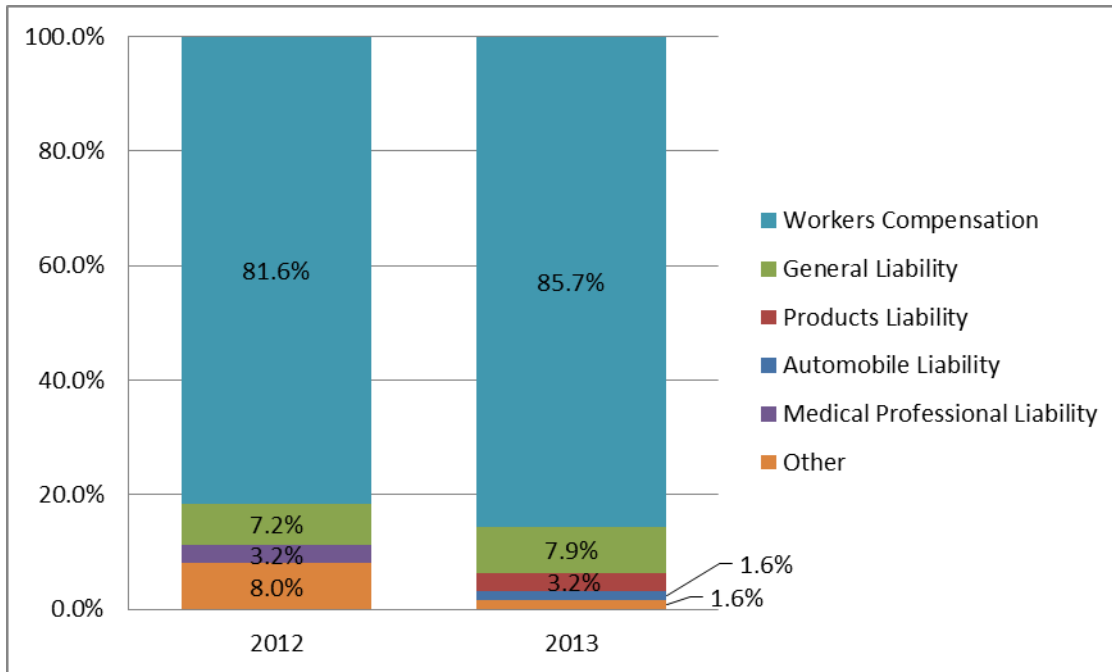


Question 10: Do you have actuarial support in regards to the collateral held for the run-off program?



Question 10 indicates that 62% to 66% of the respondents utilized actuarial support in regards to run-off collateral in 2009 through 2013. This percentage closely correlates with the overall percentage from question 4 regarding use of actuarial support, however, 2013 did not show a significant increase similar to question 4.



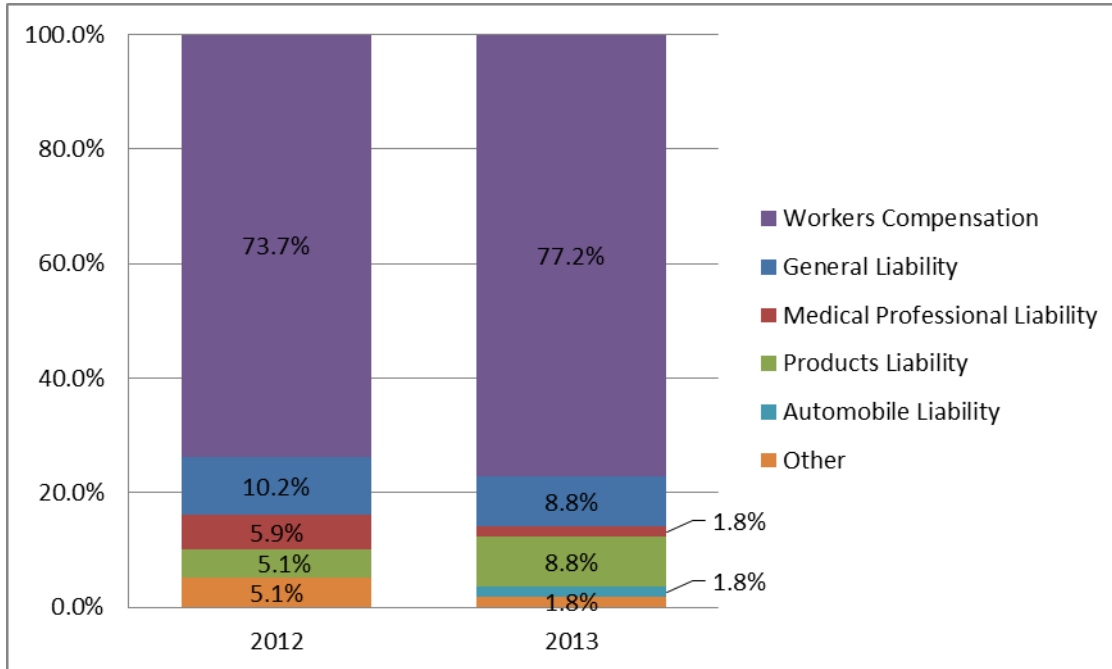
**Question 11: What is the primary risk for which collateral is posted?**

Question 11 attempts to monitor the primary risks related to the survey responses. Workers compensation represents 85.7% as the primary risk. It should be noted that “products liability” and “automobile liability” options were not available to respondents in 2012. “Medical professional liability” was not an option available to the respondents in 2013.





Question 12: What risk causes the most difficulty in relationship to collateral?



Question 12 attempts to monitor the respondent's perceptions of the most difficult risks for collateral concerns. Workers compensation is the risk that respondents indicated was the primary risk they dealt with and it also is the risk that respondents indicated was the most difficult.

Workers compensation self-insured retentions often range from \$250,000 to \$1,000,000. Additionally, some workers compensation claims take years to settle and the payout schedule for an accident year often exceeds ten years. Many current factors are also complicating collateral and reserving issues for workers compensation. Many states continue to implement significant legislative changes related to benefits. Additionally, the Medicare "set aside" issue requires claims administrators and stakeholders to consider the future stake of Medicare on specific claims. Settlements for these claims must be approved by the Centers for Medicare and Medicaid Services.





In our prior collateral results, we included several suggestions for improving collateral negotiations. These suggestions are:

- 1) Contact your carrier in advance of the collateral review date and ask if there will be any changes in the procedures or methodology. Ask if there will be changes in the loss development factors or in the source of the loss development factors.
- 2) Ask for the carrier's collateral work papers. Verify the data used in the calculations and look for any add-on provisions for risk margin related to experience or credit risk assessment. Especially review exposure information if exposures are rapidly changing. Document and support revised exposure projections.
- 3) In run-off situations, carefully review open claims. This is especially true if there are only a small number of open claims. Gather reopened claim data and claim reporting lag data. A claims audit may be useful in the situation where there are only a few open claims.
- 4) Use industry professionals as needed. This includes using your broker, actuary, and risk management consultant to assist in negotiations.

We would appreciate feedback on the survey and its results. Let us know which questions we can improve and what questions we should consider adding. We look forward to the 2014 survey and your participation.





Further Reading:

More suggestions and observations related to collateral and our survey are available in the following papers published by IRMI (International Risk Management Institute) by SIGMA authors. We have limited reprints available, so please let us know if you're interested:

"Collateral Trends, Issues, and Tactics." *Risk Financing Perspectives*, March 2010, by L. Michelle Bradley.

"Reducing Collateral Uncertainty: A Primer for Negotiations." *Risk Financing Perspectives*, 2006, by L. Michelle Bradley and Lloyd Kelly.

"Reducing Collateral Uncertainty." *Risk Financing*, Section III.L, 2008, by L. Michelle Bradley and Lloyd Kelly.

"Current Collateral Trends." *Risk Financing Supplement*, June 2011, by L. Michelle Bradley.

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